Supreme Court, U.S.
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No. 91-1793

In the Supreme Court of the United States

OCTOBER TERM, 1992

JAMES ALBERT COONES, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTIONS PRESENTED

1. Whether the Federal Deposit Insurance Corporation (FDIC) could challenge the validity of petitioner's claim that certain property of the bankruptcy estate was exempt from distribution to creditors, even though the FDIC failed to file a timely objection to the exemption claim.

2. Whether the court of appeals correctly determined that under 11 U.S.C. 552 the FDIC had a security interest in post-petition property because that property was produced with the proceeds of pre-petition property in which the FDIC had a security interest.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-21a) is reported at 954 F.2d 596. The opinions of the district court (Pet. App. 22a-56a, 57a-79a) are unreported. The opinions of the bankruptcy court (Pet. App. 80a-90a, 91a-94a) are also unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 3, 1992. A petition for rehearing was denied on February 14, 1992. Pet. App. 1a-2a. The petition for a writ of certiorari was filed on April 15,

1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, a Wyoming cattleman and farmer, and his wife (the debtors) jointly obtained two loans in 1986 totaling approximately $470,000 from the Stockmen's Bank & Trust Company. Pet. App. 24a. In connection with those loans, they executed two promissory notes and two security agreements. The security agreements gave Stockmen's a secured interest in:

> All farm products of the [debtors], whether now owned or hereafter acquired including but not limited to (i) all poultry and livestock and their young, products thereof and produce thereof, (ii) all crops, whether annual or perennial, and the products thereof * * *: [and]
>
> All inventory of cattle, horses, and all other livestock, all farm products of cattle, horses, and all farm equipment and machinery, * * * farm products, * * * crops, crop inventory and crop farm products * * * now owned or hereafter acquired.

Id. at 5a-6a.

On October 20, 1988, the debtors filed a petition in the United States Bankruptcy Court for the District of Wyoming, seeking relief under Chapter 11 of the Bankruptcy Code. At the time they filed their petition, the debtors did not submit all of the schedules and statements required under Bankruptcy Rule 1007, nor did they ask for an extension of time to file them.[1] In particular, the debtors did not file a com-

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[1] Bankruptcy Rule 1007(b)(1) requires the debtor in a Chapter 11 case to file schedules of assets and liabilities, a schedule of current income and expenditures, a statement of

pleted schedule of exemptions until November 16, 1988, 27 days after the petition was filed. Pet. App. 71a-72a.[2]

In their bankruptcy schedule, the debtors listed as exempt property 75 percent of the livestock they acquired after 1986 and all of the crops grown after 1986. They asserted that this property was exempt as personal service earnings under Wyoming law. Pet. App. 6a. No timely objection to this exemption claim was filed by any interested party. See 11 U.S.C. 522(*l*); Bankr. R. 4003(b).

2. The Federal Deposit Insurance Corporation (FDIC) was appointed receiver of Stockmen's in 1987. In that capacity, the FDIC was the holder of the notes and security agreements that the debtors had executed in favor of Stockmen's in 1986. Pet. App. 24a. In February 1989, the debtors applied to the bankruptcy court to avoid the FDIC's liens on the crops and livestock as to which they had claimed an exemption. See 11 U.S.C. 522(f). In March 1989, after becoming aware of the debtors' bankruptcy filing, the FDIC filed a motion to prohibit the debtors' use of cash collateral. See Pet. App. 61a; 11 U.S.C. 363(e).

The bankruptcy court denied the debtors' claimed exemptions, despite the lack of a timely objection by the FDIC, holding that the exemptions had no basis

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financial affairs, and a statement of executory contracts. Under Rule 1007(c), these schedules and statements must "be filed with the petition * * *, or if the petition is accompanied by a list of all the debtor's creditors and their addresses, within 15 days thereafter."

[2] Under Rule 4003(a), "[a] debtor shall list the property claimed as exempt under § 522 of the Code on the schedule of assets required to be filed by Rule 1007."

in state law. Pet. App. 91a-94a. The court also denied the FDIC's motion to prohibit use of cash collateral with respect to the FDIC's interest in debtors' crops, holding that the FDIC did not have an enforceable security interest in that property. *Id.* at 80a-88a.

3. On cross-appeals, the district court certified to the Wyoming Supreme Court the question whether state law permitted the debtors to exempt livestock acquired and crops grown after 1986 as "personal service earnings." Pet. App. 64a-65a. The Wyoming Supreme Court confirmed the bankruptcy court's view that the exemptions were not valid under state law. *Coones* v. *FDIC*, 796 P.2d 803, 804, 806 (1990).

Based on the Wyoming Supreme Court's decision, the district court held that the debtors were not entitled to the exemptions, despite the FDIC's failure to file a timely objection to their exemption claims. Pet. App. 65a-76a. The court determined that the automatic exemption feature of 11 U.S.C. 522(*l*)—which states that "[u]nless a party in interest objects, the property claimed as exempt on [the exemption] list is exempt"—did not apply here because the debtors' "untimely filing of the statements and schedules prejudiced all of the creditors including the FDIC." Pet. App. 75a.

In a separate order, the district court reversed the bankruptcy court's determination that the FDIC did not have a perfected security interest in the debtors' crops. Pet. App. 22a-56a. It rejected the debtors' argument that 11 U.S.C. 552(a) extinguished the FDIC's lien on the post-petition crops. The court determined that, because "the [debtors] used the proceeds from the FDIC's pre-petition crops to create the post-petition property," the post-petition property

constituted "proceeds" in which the FDIC retained a secured interest pursuant to 11 U.S.C. 552(b). Pet. App. 50a.[3]

4. The court of appeals affirmed. Pet. App. 3a-21a.[4] It agreed with the district court that the FDIC's failure to object to the debtors' exemption claim did not "preclude the bankruptcy court's exercise of its authority to deny an exemption that ha[d]

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[3] Section 552 (11 U.S.C.) provides:

> (a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
>
> (b) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

[4] While the cross-appeals were pending in the district court, the bankruptcy court denied confirmation of the debtors' proposed Chapter 11 plan. Subsequently, the bankruptcy court denied the debtors' motion to convert to a Chapter 12 proceeding. On March 29, 1990, the bankruptcy court granted the creditors' motion to dismiss the Chapter 11 proceeding, but gave the debtors ten days to elect to convert to a case under Chapter 7. Petitioner's wife converted to a Chapter 7 case, but petitioner did not do so. Instead, he appealed the order dismissing the case. That appeal is pending.

no legal basis." *Id.* at 10a. It also agreed with the district court that the FDIC had a perfected security interest in the debtors' post-petition crops under 11 U.S.C. 552(b). *Id.* at 11a-18a.

ARGUMENT

The decision of the court of appeals was issued prior to this Court's decision in *Taylor* v. *Freeland & Kronz*, 112 S. Ct. 1644 (1992). We do not believe that the lower court's ruling is consistent with *Taylor*. With respect to the first question presented, the petition for certiorari should accordingly be granted, and the case remanded to the court of appeals for further consideration. The second question presented does not warrant further review.

1. Petitioner first contends that the property he claimed as exempt automatically achieved exempt status under 11 U.S.C. 522(*l*) when the FDIC failed to file a timely objection to his exemption claim. Pet. 16-18. He also contends that the decision of the court of appeals to the contrary conflicts with *Taylor* v. *Freeland & Kronz*, 938 F.2d 420 (3d Cir. 1991), aff'd, 112 S. Ct. 1644 (1992).

Under Section 522(b) of the Bankruptcy Code, 11 U.S.C. 522(b), the debtor in a bankruptcy proceeding may exempt certain property of the estate from distribution to creditors. To take advantage of this exemption feature, the debtor is required under Section 522 (*l*) to "file a list of property that the debtor claims as exempt." 11 U.S.C. 522(*l*). Section 522(*l*) further provides that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." *Ibid.* Although Section 522(*l*) does not prescribe a time limit for objecting to exemption claims, Bankruptcy Rule 4003(b) provides that "[t]he trustee or any creditor may file objections to

the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) * * * unless, within such period, further time is granted by the court."

In *Taylor*, this Court held that a creditor who fails to file a timely objection to an exemption claim is barred from later contesting the validity of that claim. 112 S. Ct. at 1648-1649. The creditor in *Taylor* had argued that, notwithstanding the language of Section 522(*l*), courts could "invalidate a claimed exemption after expiration of the 30-day period if the debtor did not have a good-faith or reasonably disputable basis for claiming it." 112 S. Ct. at 1648. The Court rejected that argument, determining that "[b]y negative implication, the Rule indicates that creditors may not object after 30 days" unless further time had been granted by the bankruptcy court. *Ibid.*[5] The Court held that the creditor in the case before it "[could not] contest the exemption at this time whether or not [the debtor] had a colorable statutory basis for claiming it." *Ibid.*

In the present case, by contrast, the court of appeals held that, because "Section 522 * * * contains an implicit requirement that the claimed exemption have a valid statutory basis," "[t]he lack of a timely objection will not preclude the bankruptcy court's exercise of its authority to deny an exemption that has no legal basis." Pet. App. 9a, 10a. That reading of the statute cannot be reconciled with this Court's holding in *Taylor*. Accordingly, we believe that,

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[5] The creditor in *Taylor* also contended that, despite his failure to object in a timely manner, the bankruptcy court had authority to consider the validity of the exemption claim under 11 U.S.C. 105(a). The Court declined to consider that contention because it was not raised in the courts below. 112 S. Ct. at 1649.

with respect to the first question presented, the Court should grant the petition, vacate the judgment of the court of appeals, and remand for further consideration in light of this Court's decision in *Taylor*.

2. Petitioner also challenges the court of appeals' holding that under 11 U.S.C. 552(b) the FDIC had a perfected security interest in crops acquired after the petition for bankruptcy was filed. Pet. 18-21. That contention does not warrant further review.

Section 552 of the Bankruptcy Code addresses the effect of pre-petition security agreements on property acquired after the petition has been filed. Section 552(a) provides that "[e]xcept as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. 552(a). Section 552(b), in turn, provides that, with exceptions not pertinent here:

> [I]f the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds * * * of such property, then such security interest extends to such proceeds * * * to the extent provided by such security agreement and by applicable nonbankruptcy law.

11 U.S.C. 552(b).

In the present case, the district court found that petitioner and his wife "used the proceeds from the FDIC's pre-petition crops to create the post-petition property" in which the FDIC claimed an interest. Pet. App. 50a. The court of appeals accepted that finding, observing that petitioner did not identify any

evidence to contravene it. *Id.* at 19a-21a; see also *id.* at 4a-5a (applying "clearly erroneous" standard of review to findings of fact). The court of appeals held that "because the post-petition crops were produced with the proceeds of debtors' pre-petition crops, proceeds in which the FDIC's security interest continued after initiation of bankruptcy proceedings, § 552 did not extinguish the FDIC's secured interest in the post-petition crops." *Id.* at 19a.

The court of appeals' holding reflects a straightforward reading of Section 552(b). Section 552(b) applies when a security agreement covering pre-petition property creates a security interest both in the property and the "proceeds" of that property. In that situation, Section 552(b) provides that the holder of the security interest retains an interest in the proceeds, even if those proceeds are acquired after commencement of the bankruptcy case. Having determined that the debtors' post-petition crops were created with the proceeds of pre-petition crops in which the FDIC had a security interest, the court of appeals correctly concluded that the FDIC retained an interest in the post-petition crops under Section 552(b).

Contrary to petitioner's suggestion, the court of appeals' conclusion does not conflict wtih the decision of any other court of appeals.[6] Moreover, the decision

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[6] Petitioner contends (Pet. 19) that the decision of the court of appeals in this case "appears to conflict" with *In re Bering Trader, Inc.*, 944 F.2d 500 (9th Cir. 1991), and *In re Jones*, 908 F.2d 859, 860 (11th Cir. 1990). In each of those cases, however, the court of appeals merely held—on facts quite different from those of this case—that the post-petition property at issue did not constitute "proceeds" of pre-petition property in which the creditor held a security interest. See *In re Bering Trader*, 944 F.2d at 501-502 (post-petition rent payments on a charter vessel were not "proceeds"); *In re*

of the court of appeals below accords with decisions in other circuits involving similar facts. See *In re Bumper Sales, Inc.*, 907 F.2d 1430, 1439 (4th Cir. 1990); *J. Catton Farms, Inc.* v. *First Nat'l Bank*, 779 F.2d 1242, 1244, 1246-1247 (7th Cir. 1985); see also B. Clark, *The Law of Secured Transactions under the Uniform Commercial Code* ¶ 6.6[3], at 6-47 (1980). Further review is therefore not warranted.

CONCLUSION

With respect to the first question presented, the petition for a writ of certiorari should be granted, the judgment below vacated, and the case remanded to the court of appeals for further consideration in light of *Taylor* v. *Freeland & Kronz*, 112 S. Ct. 1644 (1992). With respect to the second question presented, the petition should be denied.

Respectfully submitted.

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Jones, 908 F.2d at 860-861 (post-petition increase in cash surrender value of life insurance policy was not "proceeds"). These fact-specific holdings are inapposite here.

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